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C O N F I D E N T I A L SECTION 01 OF 02 LILONGWE 000842

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TAGS: [EFIN](#) [ECON](#) [MI](#)

SUBJECT: MALAWI'S CENTRAL BANK FIGHTS TO MAINTAIN KWACHA

Classified By: Econoff William R. Taliaferro for reasons 1.5 b and d

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SUMMARY  
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[1](#)1. (U) With the Malawian kwacha under increasing pressure, the Reserve Bank of Malawi (RBM) has so far managed to maintain its value by using a combination of methods, conventional and otherwise. A small, heavily invested market with few speculative options has helped them up to now. In the long run, RBM's tricks cannot substitute for a solid fiscal policy. End summary.

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CONVENTIONAL TOOLS: MORAL SUASION AND CAPITAL CONTROLS  
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[1](#)2. (U) The Reserve Bank of Malawi describes its efforts to maintain the kwacha's value as a combination of intervention in the market and "moral suasion," made the more effective by a lack of attractive investment alternatives to treasury bills. This seems to be borne out by the continuance of fully subscribed T-bill auctions despite sharply lower interest rates and a higher volume of issuances over the past several months (though real rates, at about 15 percent, are still high). Given most financial institutions' already heavy stake in government paper, there is some incentive to keep buying simply in the fact that new issuances are largely financing current maturities. Senior executives at the bank acknowledge that traditional tools, including higher liquidity reserve requirements (currently 27.5 percent) and a controlled capital account, are helping to keep speculative pressures down despite high liquidity and low foreign exchange reserves (1.5 months, against a normal seasonal reserve of 2.5 to 3 months).

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NOT-SO-MORAL SUASION WORKS, TOO  
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[1](#)3. (C) Outside the bank, we have heard that the RBM is using other, less ethical tools as well. The state-controlled tobacco auction is the main source of dollars in the economy. The bank has said that it is buying dollars from the auction floor to ensure timely transaction times and a consistent exchange rate, and is benefitting more or less incidentally from controlling the dollars. According to a senior executive at the National Bank of Malawi, RBM is requiring the auctioneer to clear all dollar sales through the RBM, except for those deposited directly to dollar denominated accounts. This gives RBM a monopoly on about half of the dollars flowing through the floor, to the (possibly illegal) exclusion of commercial banks.

[1](#)4. (C) The other instrument takes more direct aim at controlling speculation in the commercial banks. According to a discount house executive, the RBM has threatened not to sell currency to banks if they do not observe an unofficial floor on the kwacha's value against the dollar (currently said to be MK110/dollar). This measure has allegedly been used in the past on Stanbic Bank, at a measurable cost in market share.

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COMMENT: IN THE LONG RUN, IT'S ABOUT RESPONSIBILITY  
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[1](#)5. (C) Nearly every informed observer of the kwacha characterizes its position as precarious. The RBM has succeeded up to now in defending its currency, despite thin reserves and, until June, increasingly inflationary spending by government. The bank is quick to say the market here is so small that normal market dynamics (according to which a lowering of rates would lessen demand) do not apply. This is their logic for arguing against the IMF's demands for higher bank rates: since rate changes seem not to affect demand for

government paper, the GOM should pay as little as the market will bear. To the extent that RBM can squelch other investment opportunities, and they evidently can, the situation will probably stay contained for the time being. In the longer run, though, the bank's machinations have to be backed by a responsible fiscal policy. So far, the Mutharika government appears to be cognizant of the danger and determined to avoid it.

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